ESSENTIAL UTILITIES INC

Essential Utilities Inc., formerly Aqua America Inc., is a publicly traded water and wastewater utility holding company with operating subsidiaries serving approximately five million people in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, Indiana, Kentucky, West Virginia and Virginia. In addition to its water/wastewater utilities, the company purchased a natural gas utility in March 2020. The combined company has roughly 2,000 employees.

Analyst's Notes

Analysis by Argus Kelleher-Ferguson, October 13, 2020

ARGUS RATING: BUY

- Reiterating BUY with target of $50
- WTRG shares remain 23% below their all-time high and currently offer investors a favorable entry point.
- In a transformative deal, the company recently acquired Peoples, a natural gas utility, for $4.2 billion in cash. It has also received regulatory approval for rate hikes and infrastructure surcharges in a range of states.
- The company has a long record - 75 years - of paying dividends. The current yield is about 2.4%.

INVESTMENT THESIS

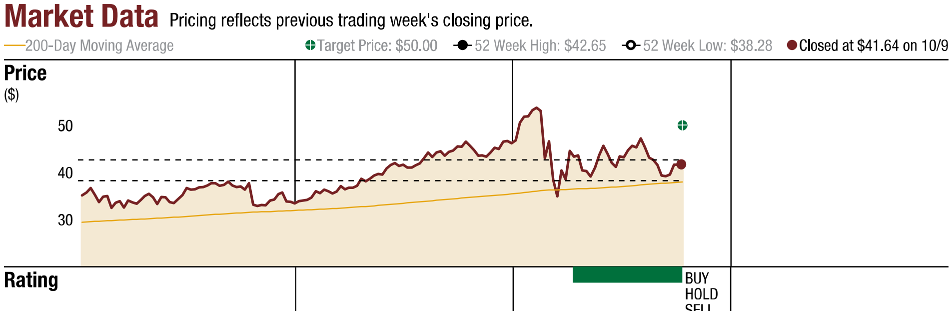
BUY-rated Essential Utilities Inc. (NYSE: WTRG) has a solid business model, a history of steady earnings growth, and a growing dividend. We think the company will continue to provide shareholders with solid risk-adjusted returns. Essential stands to benefit from aging water infrastructure that, according to many industry observers, will soon require substantial investment. In 2019, EPA Chief Andrew Wheeler projected that $700 billion would be needed over the next 20 years to upgrade/overhaul U.S. water infrastructure. Similarly, in August 2020, the American Society of Civil Engineers released a report detailing chronic underinvestment in drinking water & wastewater systems. The report highlighted the difficulties plaguing legacy systems, with many treatment facilities nearing the end of their design lives of 75-100 years. Looking ahead, we expect Essential Utilities to benefit from both new investment in water infrastructure and upgrades of existing systems.

In addition, Essential expects to grow its customer base, helped by operations in states such as North Carolina and Texas, where population growth is above the national average. The company also benefits from an experienced management team and balanced rate regulation. Our 12-month price target is $50.

RECENT DEVELOPMENTS

Market Data

Pricing reflects previous trading week's closing price.



EPS ($)

FY ends Dec 31	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4
Quarterly	0.28	0.37	0.44	0.31	0.28	0.37	0.48	0.34	0.60	0.29	0.28	0.38	0.63	0.31	0.30	0.40
Annual	1.40				1.47				1.55 (Estimate)				1.64 (Estimate)			

Revenue ($ in Mil.)

FY ends Dec 31	2018 Q1	2018 Q2	2018 Q3	2018 Q4	2019 Q1	2019 Q2	2019 Q3	2019 Q4	2020 Q1	2020 Q2	2020 Q3	2020 Q4	2021 Q1	2021 Q2	2021 Q3	2021 Q4
Quarterly	194.3	212.0	226.1	205.8	201.1	219.0	244.0	226.3	256.0	384.0	387.8	446.0	563.2	391.7	395.6	463.9
Annual	838.2				890.4				1473.9 (Estimate)				1814.3 (Estimate)			

Argus Recommendations

Twelve Month Rating	SELL	HOLD	**BUY**
Five Year Rating	SELL	HOLD	**BUY**
Sector Rating	Under Weight	Market Weight	**Over Weight**

Argus assigns a 12-month BUY, HOLD, or SELL rating to each stock under coverage.

- BUY-rated stocks are expected to outperform the market (the benchmark S&P 500 Index) on a risk-adjusted basis over the next year.
- HOLD-rated stocks are expected to perform in line with the market.
- SELL-rated stocks are expected to underperform the market on a risk-adjusted basis.

The distribution of ratings across Argus' entire company universe is: 63% Buy, 36% Hold, 1% Sell.

Key Statistics

Key Statistics pricing data reflects previous trading day's closing price. Other applicable data are trailing 12-months unless otherwise specified

Market Overview

Price	$42.25
Target Price	$50.00
52 Week Price Range	$30.40 to $54.52
Shares Outstanding	245.15 Million
Dividend	$1.00

Sector Overview

Sector	Utility
Sector Rating	OVER WEIGHT
Total % of S&P 500 Market Cap.	3.00%

Financial Strength

Financial Strength Rating	MEDIUM
Debt/Capital Ratio	44.4%
Return on Equity	8.2%
Net Margin	25.2%
Payout Ratio	0.63
Current Ratio	6.31
Revenue	$1.11 Billion
After-Tax Income	$279.13 Million

Valuation

Current FY P/E	27.26
Prior FY P/E	28.74
Price/Sales	9.33
Price/Book	2.23
Book Value/Share	$18.91
Market Capitalization	$10.36 Billion

Forecasted Growth

1 Year EPS Growth Forecast	5.44%
5 Year EPS Growth Forecast	9.00%
1 Year Dividend Growth Forecast	6.59%

Risk

Beta	0.97
Institutional Ownership	67.73%

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Analyst's Notes...Continued

WTRG shares have underperformed the S&P over the last quarter, falling 2% while the S&P 500 has climbed 9%. The stock has also underperformed over the past year, with a decline of 7% compared to a 17% advance for the broad market. The shares have outperformed the Utility industry ETF IDU over the past year. The beta on WTRG shares is 0.47.

On August 5, the company reported 2Q adjusted EPS of $0.29, above the consensus forecast of $0.24 but down from $0.37 in 2Q19. On a GAAP basis, EPS rose to $0.29 from $0.25 in 2Q19. Revenue rose 76% to $384 million, primarily reflecting contributions from Peoples, a natural gas utility acquired in March.

The company acquired Peoples for $4.2 billion in cash, including the assumption of $1.3 billion in debt. Peoples serves about 740,000 customers in Pennsylvania, Kentucky, and West Virginia. During Essential's second-quarter conference call, management announced that Mike Huwar would succeed Joe Gregorini as president of Peoples. Mr. Huwar has over 30 years of industry experience and is well regarded by Pennsylvania regulators.

Along with its 2Q earnings, management reiterated its 2020 guidance calling for adjusted EPS of $1.53-$1.58. The guidance assumes compound annual earnings growth of 5%-7% through 2022, infrastructure investments of $2.8 billion through 2022, and customer growth of 2%-3% per year in the regulated water segment.

EARNINGS & GROWTH ANALYSIS

The company's top-line growth is driven by acquisitions, volume increases and rate increases. In 2Q20, revenue rose significantly due to the Peoples acquisition. Excluding the acquisition, revenue still rose an impressive 9%, reflecting increased residential water usage, partially offset by lower usage from commercial and industrial customers.

On the regulatory front, to date in 2020, Essential's regulated water segment has received approval for higher rates or infrastructure surcharges in Illinois, Indiana, North Carolina, Ohio, Virginia and Pennsylvania. The changes will provide an estimated $10.2 million in additional annualized revenue. The company has additional proceedings pending in Indiana, New Jersey, Virginia and Ohio for its regulated water segment, which could provide another $5.2 million in revenue. Essential's regulated natural gas segment has also received approval for higher rates or infrastructure surcharges in Kentucky and Pennsylvania that will generate approximately $1 million in annualized revenue.

Below the top line, O&M expense rose 49% from 2Q19 due to new Peoples O&M, partially offset by merger-related synergies.

Turning to our estimates, we are maintaining our 2020 non-GAAP EPS estimate of $1.55, near the midpoint of management's guidance range and implying growth of 5% this year. We think the company will control costs and improve the efficiency of acquired assets, invest in infrastructure projects, and grow its customer base both organically and through acquisitions. The company plans to invest $950 million in gas and water

Growth & Valuation Analysis

GROWTH ANALYSIS

($ in Millions, except per share data)	2015	2016	2017	2018	2019
Revenue	814	820	810	838	890
COGS	309	297	282	308	333
Gross Profit	505	523	527	530	557
SG&A	—	—	—	—	—
R&D	—	—	—	—	—
Operating Income	321	333	334	323	340
Interest Expense	77	81	88	99	100
Pretax Income	217	255	257	178	212
Income Taxes	15	21	17	-14	-13
Tax Rate (%)	7	8	7	—	—
Net Income	202	234	240	192	225
Diluted Shares Outstanding	178	178	178	178	216
EPS	1.14	1.32	1.35	1.08	1.04
Dividend	0.69	0.74	0.79	0.85	0.91
GROWTH RATES (%)					
Revenue	4.4	0.7	-1.3	3.5	6.2
Operating Income	2.1	3.8	0.2	-3.2	5.3
Net Income	-13.5	16.1	2.4	-19.9	17.0
EPS	-5.0	15.8	2.3	-20.0	-3.7
Dividend	8.2	7.7	7.2	7.0	7.0
Sustainable Growth Rate	6.6	4.7	5.2	5.1	-1.1
VALUATION ANALYSIS					
Price: High	$31.09	$35.83	$39.55	$39.38	$47.33
Price: Low	$24.40	$28.03	$29.41	$32.09	$32.70
Price/Sales: High-Low	6.8 - 5.3	7.8 - 6.1	8.7 - 6.5	8.4 - 6.8	11.5 - 7.9
P/E: High-Low	27.3 - 21.4	27.1 - 21.2	29.3 - 21.8	36.5 - 29.7	45.5 - 31.4
Price/Cash Flow: High-Low	14.9 - 11.7	16.9 - 13.2	18.1 - 13.5	18.0 - 14.7	31.3 - 21.6

Financial & Risk Analysis

FINANCIAL STRENGTH	2017	2018	2019
Cash ($ in Millions)	4	4	1,869
Working Capital ($ in Millions)	-153	-252	1,694
Current Ratio	0.46	0.37	6.31
LT Debt/Equity Ratio (%)	102.6	119.4	76.1
Total Debt/Equity Ratio (%)	109.7	127.8	79.8
RATIOS (%)			
Gross Profit Margin	65.1	63.2	62.6
Operating Margin	41.2	38.6	38.2
Net Margin	29.6	22.9	25.2
Return On Assets	3.8	2.9	2.8
Return On Equity	12.6	9.7	7.6
RISK ANALYSIS			
Cash Cycle (days)	-22.0	-33.7	-36.4
Cash Flow/Cap Ex	0.8	0.7	0.6
Oper. Income/Int. Exp. (ratio)	3.9	2.8	2.7
Payout Ratio	60.4	58.5	59.5

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Analyst's Notes...Continued

infrastructure in 2020, following investments of $550 million in water infrastructure in 2019. WTRG will use the funds to replace pipes and strengthen service reliability, among other projects. We look for continued growth in 2021 and are maintaining our EPS forecast of $1.64.

FINANCIAL STRENGTH & DIVIDEND

Our financial strength rating for Essential Utilities is Medium, the midpoint on our five-point scale. Our three main financial strength criteria are debt levels, fixed-cost coverage, and profitability. Moody's rates the company's debt at Baa2 with a stable outlook. S&P's rating is A.

WTRG had $7 million in cash and $5.2 billion in debt at the end of 2Q20. The company's total debt/capitalization ratio was 53%. On April 13, the company completed a $1.1 billion public debt offering, with $500 million of 10-year 2.7% notes and $600 million of 30-year 3.3% notes, for a weighted-average maturity of 20.9 years and a weighted-average coupon of 3.0%. On April 14, the company priced $175 million of first mortgage bonds for Aqua Pennsylvania. The proceeds were used to pay off short-term borrowings and to fund an acquisition. As of May 1, after considering the effects of these financings, the company had $1.1 billion in borrowing capacity on various credit facilities.

On August 4, the Essential Utilities board approved a dividend hike. The quarterly cash dividend is now $0.2507, up from $0.2343. The annual distribution of roughly $1.00 yields about 2.4%. WTRG has grown its dividend at a 7% average annual rate over the last five years. It has paid consecutive quarterly dividends for 75 years, and has raised the dividend 30 times in the past 29 years. Our 2020 dividend estimate is $0.97, down from $0.98, and our 2021 estimate is $1.04, up from $1.02.

MANAGEMENT & RISKS

Christopher Franklin has been CEO since July 2015. Mr. Franklin is a 25-year veteran of the company, and previously served as president and COO of its regulated operations. The current COO is Richard Fox, who has served in the role since 2015, and the CFO is Daniel J. Schuller, who has been in the position since 2018.

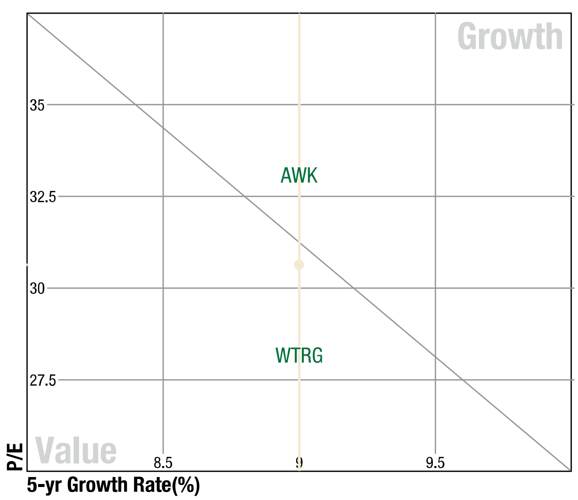
The U.S. water industry is fragmented, with more than 53,000 individual water systems. Many of these systems cannot afford to meet the EPA's increasingly stringent standards, and have put themselves up for sale. Several companies have even sought to be acquired by Essential Utilities. The range of acquisition targets has also grown as cash-strapped municipalities look to monetize their utility assets. We believe that WTRG will be able to acquire additional municipal water systems in the coming years as cities look to raise cash amid rising pandemic-related costs.

Key risks for water utilities include the effect of adverse weather on revenues, regulatory issues (especially related to construction cost recovery), and potential environmental and safety-related liabilities. In addition, the utility's heavy capital needs create

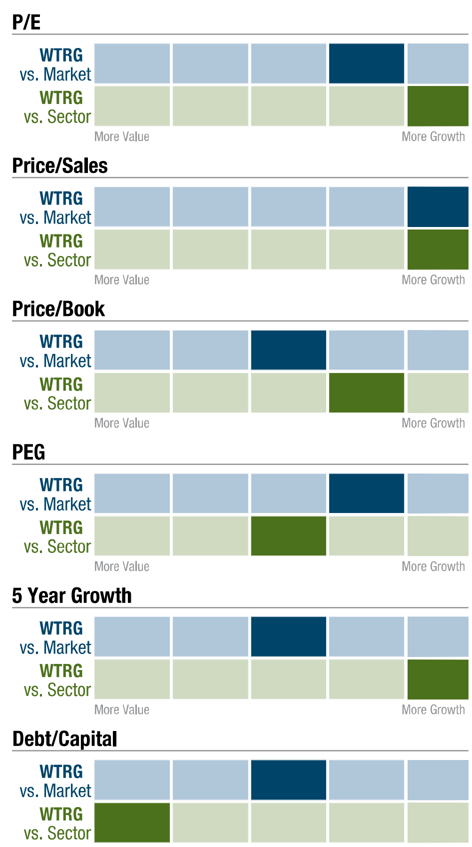
Peer & Industry Analysis

The graphics in this section are designed to allow investors to compare WTRG versus its industry peers, the broader sector, and the market as a whole, as defined by the Argus Universe of Coverage.

- **The scatterplot shows how WTRG stacks up versus its peers on two key characteristics: long-term growth and value. In general, companies in the lower left-hand corner are more value-oriented, while those in the upper right-hand corner are more growth-oriented.**
- **The table builds on the scatterplot by displaying more financial information.**
- **The bar charts on the right take the analysis two steps further, by broadening the comparison groups into the sector level and the market as a whole. This tool is designed to help investors understand how WTRG might fit into or modify a diversified portfolio.**



Ticker	Company	Market Cap ($ in Millions)	5-yr Growth Rate (%)	Current FY P/E	Net Margin (%)	1-yr EPS Growth (%)	Argus Rating
AWK	American Water Works Co. Inc.	23,721	9.0	33.1	17.4	10.1	BUY
WTRG	Essential Utilities Inc	10,703	9.0	28.2	27.5	5.8	BUY
Peer Average		**17,212**	**9.0**	**30.6**	**22.4**	**8.0**	



Analyst's Notes...Continued

ongoing liquidity risk.

COMPANY DESCRIPTION

Essential Utilities Inc., formerly Aqua America Inc., is a publicly traded water and wastewater utility holding company with operating subsidiaries serving approximately five million people in Pennsylvania, Ohio, North Carolina, Illinois, Texas, New Jersey, Indiana, Kentucky, West Virginia and Virginia. In addition to its water/wastewater utilities, the company purchased a natural gas utility in March 2020. The combined company has roughly 2,000 employees.

VALUATION

WTRG shares appear attractively valued at current prices near $42. Over the past 52 weeks, the shares have traded between $30 and $55. They are currently about 23% below their all-time high.

WTRG shares are trading at a discount to peers on P/E and price/book, but at a premium based on price/sales, which we feel is justified by the company's solid long-term fundamentals. The shares trade at 27.3-times our 2020 EPS estimate, below the peer average of 32.2. In our view, the company's financial strength, favorable risk profile, visible forward earnings stream and attractive integrated structure make WTRG a compelling investment. Our target price is $50.

On October 13 at midday, BUY-rated WTRG traded at $41.99, down $0.26.

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About Argus

Argus Research, founded by Economist Harold Dorsey in 1934, has built a top-down, fundamental system that is used by Argus analysts. This six-point system includes Industry Analysis, Growth Analysis, Financial Strength Analysis, Management Assessment, Risk Analysis and Valuation Analysis.

Utilizing forecasts from Argus' Economist, the Industry Analysis identifies industries expected to perform well over the next one-to-two years.

The Growth Analysis generates proprietary estimates for companies under coverage.

In the Financial Strength Analysis, analysts study ratios to understand profitability, liquidity and capital structure.

During the Management Assessment, analysts meet with and familiarize themselves with the processes of corporate management teams.

Quantitative trends and qualitative threats are assessed under the Risk Analysis.

And finally, Argus' Valuation Analysis model integrates a historical ratio matrix, discounted cash flow modeling, and peer comparison.

THE ARGUS RESEARCH RATING SYSTEM

Argus uses three ratings for stocks: BUY, HOLD, and SELL. Stocks are rated relative to a benchmark, the S&P 500.

- A BUY-rated stock is expected to outperform the S&P 500 on a risk-adjusted basis over a 12-month period. To make this determination, Argus Analysts set target prices, use beta as the measure of risk, and compare expected risk-adjusted stock returns to the S&P 500 forecasts set by the Argus Market Strategist.
- A HOLD-rated stock is expected to perform in line with the S&P 500.
- A SELL-rated stock is expected to underperform the S&P 500.

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